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SUBJECT: Argentina Renationalizes Flag Carrier Aerolineas Argentinas

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11. (SBU) SUMMARY: On September 3, Argentina's Senate approved the re-nationalization of Aerolineas Argentinas (AR) and its sister carrier Austral, formally marking the return of the financially troubled flag carrier from the Spanish travel conglomerate Marsans Group to state hands. In announcing this action, and reflecting the strong support from the GOA, unions, and most of the opposition, President Cristina Fernandez de Kirchner (CFK) vowed to again "make Argentines proud" of their national carrier. The 46-21 vote followed an earlier Lower House approval, and gives the GOA the sole right to determine what price, if any, the GOA will pay Marsans for the carriers, and also ruled out any future privatizations. The vote culminated recent conflict and exchanges of blame among and between the GOA, airline unions, Marsans, and the political opposition over the air carriers' financial woes, labor conflicts, and an estimated US\$890 million in debt, and also raised questions about the GOA's own oversight role of the carriers in recent years. Opposition politicians have demanded to know why the airlines failed despite a near-domestic monopoly, advantageous international route rights, preferential airport fees, and while Argentina is enjoying the biggest tourism boom in its history. Difficult decisions still remain unresolved: determining the financial situation of both airlines; deciding on a price to be paid to Marsans; and deciding how these carriers will be managed in the future. Many local analysts doubt that this renationalization will guarantee improved carrier finances, union peace or better service. It remains questionable to many observers here whether the GOA is financially or technically capable of running such an operation efficiently and effectively, especially in today's challenging global aviation market. Pending GoA decisions on this will have important consequences in future tourism, trade, and investment prospects. Several U.S. companies are service and aircraft suppliers to the airlines and have had problems collecting monies owed. Embassy will be alert to their interests. END SUMMARY.

Congress passes nationalization with key modifications

12. (SBU) After weeks of debate, and the Lower House's own approval two weeks earlier, the Argentine Senate on September 3 approved the formal renationalization of flag carrier Aerolineas Argentinas and its sister carrier Austral. The bill left unchanged the Lower House's bill that had been approved in late August, but is significantly different from the original proposed legislation CFK sent to Congress following the GOA-Marsans agreement signed on July 17 (ref B). The July 17 agreement envisioned the renationalization of the carriers and included a mechanism to determine the price the GOA would pay Marsans to buy out its equity in the carriers. In place of the original bill's provision to have any disagreement over this price arbitrated by a third party, the final GOA bill calls for the GOA's Valuation Tribunal to determine the price, and that price to be approved by Congress. Under the revised legislation, Marsans has no voice or vote in the matter.

13. (SBU) Marsans has stated that it considers the July 17 agreement still legally valid, and has publicly threatened to take its case before either Argentine domestic courts or the International Center for the Settlement of Investment Disputes (ICSID), arguing that the GOA could exert unfair power to expropriate the firms or otherwise force unfavorable terms on Marsans. Congress also struck out another key passage of the original GOA bill that allowed for an eventual re-privatization of the carriers. (Although the possibility still exists that the carriers can be run by a concession.)

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A bitter divorce and exchanging blame

14. (SBU) The vote follows months of blame games and reprisals between the GOA, unions, Marsans, and opposition politicians about how the carriers have arrived at bankruptcy's door (with an estimated \$890 million debt), along with their infamous poor service and chronic labor conflicts (refs B, C, and D). While many GoA and union leaders celebrated this re-nationalization, some opposition figures and representatives from the media questioned the rationale for a takeover now, before the carriers have resolved the debt and labor issues. The opposition has also claimed that the public is entitled to know how such an airline could have failed. They point to the ongoing boom in international tourism, the airline's virtual monopoly on most domestic "cabotage" routes, preferential airport service fees, fuel subsidies, and its service in a country whose size and road infrastructure shortfalls make flying the only transport option for many travelers. AR and Austral together control about 85% of the domestic market, and AR holds lucrative route rights to many parts of the world.

15. (SBU) The GOA and many opposition politicians accuse Marsans of having "hollowed out" the company (selling planes and converting them to leases, selling valuable office real estate holdings), overbooking fares, failing to fulfill investment pledges, flying older and less fuel efficient planes, and scaling back less profitable routes. Marsans has publicly denied these charges, and placed the blame squarely on the GOA's own commercial air transport policies, lack of proper oversight of this important public service, and regulated below market tariffs. Marsans and opposition politicians have criticized the GOA for allowing unions to stage regular crippling strikes (ref D), and Marsans has also criticized the GoA for vetoing its repeated attempts to trim the carriers' staffs (AR has 200 employees per plane vs. the regional average of 100).

16. (SBU) Former Marsans chief executive Antonio Mata characterized Transportation Secretary Ricardo Jaime's re-nationalization push as the actions of someone who "started a fire so that he can appear as a fireman saving the company," and said that Argentina's commercial aviation policies are "30 years behind the international norm." According to a recent study by local economists Marcelo Celani and Miguel Kiguel, the average tariff in Latin America is \$1.24 per mile, vs. 54 cents in Argentina (with recent tariff increases

included, ref B). This same study also found that since 2001, Argentina domestic aviation costs have grown far more than tariff increases: in nominal terms, while fuel costs rose 900% and salaries 200%, tariffs rose only 100%.

More difficult steps lie ahead

¶7. (SBU) Congress's nationalization action marks just the initial phase of this process, and the GOA faces more difficult decisions ahead. According to local analysts, there is a three-step process that must be accomplished in order for the nationalization to be concluded: (1) determining the true financial status of the carriers; (2) coming to an agreement with Marsans on the price to be paid for AR and Austral; and (3) deciding how these carriers will be managed in the future.

¶8. (SBU) Determining the carriers' financial status has already proven to be difficult and contentious. According to local aviation group Consultair, a few months ago, before the decision was made to re-nationalize the carriers, PriceWaterhouseCoopers (PWC) reported that the airlines had a positive net worth of about \$20 million. Later, PWC presented new statements showing the net worth at about negative \$30 million. To add to this confusion, these figures did not take into account still-pending 2007 financial statements of the carriers. In recent weeks, Marsans and AR officials have agreed that estimated outstanding debts total about \$890 million, with about \$270 million in "urgent" and overdue debts (for fuel, fleet rentals, and service providers). Once Marsans presents the final 2007 figures, the numbers will be audited by the GOA's Valuation

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Tribunal.

¶9. (SBU) Once the financial status of the firms is determined, the nationalization law calls for the Valuation Tribunal to calculate these firms' combined value and report this figure to Congress for approval or rejection. Many GOA lawmakers and officials, including Transportation Secretary Jaime, have said that the outstanding deficits are so great that the question will not be how much Marsans gets paid by the GOA, but whether the GOA will claim that Marsans should simply hand over the companies for nothing - and maybe even demand that it pay all or part of the \$890 million debt. Although the GOA could in theory simply expropriate both companies, this option could lead to a long legal battle that the GOA would likely prefer to avoid, both for legal reasons and its own investment climate reputation.

¶10. (SBU) Finally, the GOA must decide how the airlines will be managed in the future, including deciding on fleet composition and routes. Currently, day-to-day decisions are being made by the team designated by GOA and Marsans as a result of their July 17 accord, whose 60-day mandate runs until September 16 (but could be extended if needed). As the Congress ruled out the possibility of re-privatizing the carriers (although it was always doubtful that they could attract any serious investors), one possibility that has been discussed in the media is the carriers being managed via a GOA concession, as is the case with the major airports. These same analysts point out the GOA manifestly lacks the expertise and capacity to run the airlines itself.

¶11. (SBU) Another point of discussion is whether the two carriers might be merged, presumably to reduce costs, or keep them separate. This is not an easy matter: the airlines have very different backgrounds, management styles, unions, routes, and fleets. Aerolineas was established in 1950 as a government carrier, while Austral was formed as a private carrier. Aerolineas has both domestic and international routes, while Austral focuses on the domestic market. Once this issue is decided, the carriers would need to decide on the appropriate aircraft types on which it will focus in the future. The interim management team, however, has decided to accelerate some of the fleet consolidation decisions. For example, older models such as AR's Boeing 747-200s, 747-400s, 737-200s, and Airbus 310s are reportedly set to be withdrawn from service, either to be sold or scrapped locally. Austral, which

flies almost exclusively the older and less fuel-efficient MD-80s, is also reported to be considering a fleet upgrade. Media reports in recent days indicate that Argentina is considering Brazilian aircraft manufacturer Embraer as a possible small jet supplier, but no details have emerged regarding possible financing or delivery times. If Argentina does pay its Paris Club debts (reftel A), this might open the door for possible favorable loan terms for U.S.-manufactured plane sales.

No guarantee of better finances, service or union peace

¶12. (SBU) According to local analysts and media reports, the GOA appears resigned to spending up to \$50 million a month, or about \$600 million annually (roughly 1% of 2008 primary expenditures) to keep the companies in operation. The GOA has already pumped in about \$130 million since mid-July to cover current expenses for salaries, fuel, leases, and spares. Some media reports have expressed the hope that with this re-nationalization and support for the carriers, the unions might start providing improved service. According to the Argentine Tourism Rights Association (AADETUR), in the first half of 2008, AR and Austral were on time only 53% of the time, compared to 79% for flights in the United States.

¶13. (SBU) One industry representative told Emboff that, on the contrary, unions could "very easily" push for even more jobs, influence and concessions, and that despite this "victory," sooner or later they will be demanding more concessions, when they realize that state ownership might not be all that they had hoped for. The local trade publication "Aviation News" reported on September 10 that AR's pilot union is already planning to hire 200 new pilots in

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the coming weeks. According to media reports, AR pilots have already gained some job advantages that had been the subject of slowdowns and strikes: they have reverted back to a 35-hour work month, versus the regional norm of 80 hours, and will go from three to four pilots for long international flights, one above the international norm. During last week's Senate debate, a Marsans representative complained that "with pilots only working 35 hours per month, we cannot be competitive while LAN pilots here work 80 hours." The same representative said that from 2001 to 2008, the total number of AR and Austral pilots employed increased from 500 to 921, while the number of operational planes has declined to 26 today.

¶14. (SBU) According to local analysts, this domestic aviation turmoil will likely not affect Argentine passengers' access to international destinations: although AR flies to some regional Latin American destinations, Miami and Europe, these destinations are already covered in sufficient numbers by U.S., Chilean, Spanish, British and other competitor carriers.

¶15. (SBU) Several U.S. companies are service and aircraft suppliers to the airlines and have had problems collecting monies owed, including Sabre Travel Network and GE Capital. Embassy will be alert to their interests and to help if needed.

Comment

¶16. (SBU) Given the bitter relationship in recent years that has existed between the GOA and unions on one side, and Marsans on the other, many observers saw this divorce as inevitable. Now that the renationalization has been approved by Congress, it is up to the GOA and unions to decide whether they can or will work to reform AR and Austral into reasonably good domestic carriers, or whether Argentina will continue to suffer sub-par, unreliable and strike-prone services. They will need to decide on a series of economic and political trade offs, including on domestic fare price increases and subsidies, quality of service, and number of employees. In the interim, the GOA will likely continue to be on the hook for around \$50 million per month in subsidies, and this is above and beyond announced plans for more planes, more routes, and the "recuperation"

of AR and Austral's "former greatness." It remains questionable to many observers here whether the GOA is financially or technically capable of running such an operation efficiently and effectively, especially in today's challenging global aviation market. Pending GoA decisions on this will have important consequences in future tourism, trade, and investment prospects. END COMMENT.

WAYNE